

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 95-0453 ST, 95-0454 ST

Sales & Use Tax

For Tax Period: 1991 Through 1993

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ISSUES

I. Sales & Use Tax - Utility Exemption

Authority: 45 IAC 2.2-4-13; 45 IAC 2.2-5-12

Taxpayer protests the Department's denial of a complete sales tax exemption for utilities.

II. Sales & Use Tax - Equipment Leases

Authority:

Taxpayer protests the Department's denial of a claimed equipment exemption.

STATEMENT OF FACTS

Both taxpayers were franchised restaurants offering full menus owned and incorporated by the same individual (Mr. C). The restaurants were located in Seymour, Indiana and Terre Haute, Indiana. As a result of an audit the Department assessed the taxpayers with sales tax on utility purchases as well as sales/use tax on the leasing of restaurant equipment. Additional relevant facts will be presented below, as necessary.

I. Sales & Use Tax - Utility Exemption

DISCUSSION

Taxpayers claim both locations were exempt from sales tax on utility consumption (electric). Taxpayers base this claim on a utility study performed by an independent contractor which found taxpayers were due a 100% exemption as the utilities were predominantly consumed for exempt purposes. 45 IAC 2.2-4-13.

The auditor did not accept the independent utility study because the study excluded several items considered non-production. Those items found to not be included or not included, at their proper taxable percentage were:

- (1) Water heater - the auditor found this water heater was used for general purposes and was not listed in the utility study.
- (2) Groen kettles - the auditor deemed fifty percent of these kettles were nonproductive as they were used to heat reconstituted soups.
- (3) Coffeemakers - the auditor found the coffeemakers were exempt only during the time the coffee was actually being brewed, not when it was holding coffee already prepared.
- (4) Indoor lighting - the auditor found some lighting left on at all times for security reasons was not listed in the study.
- (5) Heating and air conditioning units - the auditor found the stated hours for operation of these items on the study were not consistent with the climate of Indiana.

Taxpayers reject the auditors findings. First, taxpayers claim the water heater omitted from the study was a natural gas water heater and therefore was not necessary to include in the study. Second, taxpayers claim the Groen kettles are elaborate ovens used for a variety of sauce, gravy and entree preparations. Taxpayers claim no such device would be used for simply heating reconstituted soups. Taxpayers claim they served only homemade soups. Third, taxpayers rely on Department Regulation 45 IAC 2.2-5-12 (d)(1) to claim the production of coffee does not end until it is placed in its completed form, meaning its cup. The regulation states,

Direct production in the production process begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production process has altered the item to its completed form, including packaging, if required.

Taxpayers claim the regulation requires the production process does not end until the coffee is placed in its final form and the packaging is necessary before it can be served to the customer. Taxpayer also argues the auditor underestimated the number of pots of coffee served based solely on the auditors casual observations of one of the locations for an unspecified period of time.

Taxpayers also argue the indoor lighting which was omitted from the study consisted of four low-watt fixtures which did not consume enough electricity to substantially effect the validity of the study. Finally, taxpayers claim the heating was natural gas and the air conditioning formula used to determine the amount of electricity consumed was the formula specified by the Department.

Taxpayers argue other items (production and nonproduction) noted by the Department as not being included in the study would not effect the finding that the taxpayers' use of electricity was more than 50% attributable to exempt activity. Taxpayers submit a modified version of the study which includes those items and still determines the bulk of taxpayers' usage was in the service of food production.

Subsequent to taxpayers originally forwarding these arguments the auditor scheduled new visits to both locations. The auditor states many additional items were found which were not included in the study. Those items included refrigerated display cases, ice cream chests, walk-in refrigerators, ceiling fans and various lighted signs. The auditor also relied on statements from employees at each location as to the number of hours certain pieces of equipment ran and whether they were electric or gas powered. Finally, the auditor relied on statements made from employees of the franchise in regards to the accepted average rate for exempt usage.

The taxpayers made a final rebuttal of those findings of the auditor. The taxpayers claimed these additional items found, by the auditor, to have been missing from the original study were, in fact, listed. Taxpayers claimed the auditor misunderstood the technical equipment names which were used on the listing. Taxpayers also claimed the walk-in refrigerator was not listed as a whole but its component parts which consumed electricity were clearly listed. Taxpayers claimed they could not rebut the finding that certain lighted signs were omitted as the auditor did not specify which signs. Taxpayers conceded the ceiling fans were mistakenly omitted but claimed their consumption of electricity was negligible. Finally, taxpayers again emphasized the heating units were powered by natural gas and not electricity.

Taxpayers also stated the auditor's subsequent visit to the locations took place after the restaurants had been sold back to the franchise and, as such, some changes may have been made from the assessment period. Taxpayers stated it utilized some additional equipment and may have had differing uses for the equipment as that listed in a basic franchise package. Taxpayers claimed this explains how a franchise representative could accept a lesser exempt percentage.

FINDING

Taxpayers' protests are sustained. Taxpayers have proven to the Department's satisfaction that the study performed by the independent contractor is sufficient to base exempt status on the taxpayers for the assessment periods in question.

II. Sales & Use Tax - Equipment Leases

DISCUSSION

All equipment used at the two locations was owned by Mr. C and leased back to the stores. The auditor determined 86% of the equipment would be taxable in a retail sale and, therefore, is taxable when leased. Taxpayers disagreed with the exemption percentage and claimed 30% was exempt equipment. Taxpayers claimed that upon the inception of each restaurant, Mr. C purchased the basic outfitting package as required by the franchise. Taxpayers claimed the Department had allowed other franchise restaurants with the same package a 30% exemption. Taxpayers submitted to the auditor the Department's examination report of another franchise which was allowed a 40% exemption. Taxpayers claimed they should be treated the same as the other franchise as the restaurants were leasing almost identical equipment packages. Taxpayers also claimed the auditor assured them that if it was demonstrated another franchise was given a 30% exemption or higher that percentage would be accepted without further debate.

The auditor firmly denies making any such assurances to the taxpayers. The auditor states she simply agreed to look at the other franchise's study. The auditor determined to not use the study submitted from the other franchise. The auditor stated many taxable items were not listed on that study.

FINDING

Taxpayers' protests are denied. Taxpayers have not proven to the Department's satisfaction that the equipment leases are due more than a 14% exemption.